

# Does Financial Liberalization Foster Economic Growth? Empirical Evidence from ASEAN-6 Countries

Sonia Kumari Selvarajan<sup>1</sup>, Rossazana Ab-Rahim<sup>2\*</sup>, Dyg-Affizzah Awg-Marikan<sup>3</sup>

<sup>1,2,3</sup>Department of Economics, Faculty of Economics and Business, Universiti Malaysia Sarawak, 94300, Kota Samarahan, Sarawak.

\*Corresponding author E-mail: [rossazana@gmail.com](mailto:rossazana@gmail.com)

## Abstract

This paper aims to investigate the impacts of financial liberalization towards the economic growth in ASEAN-6 countries (Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam) throughout the study period of 1990 to 2015 by employing the Pooled Mean Group (PMG) estimations technique. The proxies for financial liberalization are the domestic private credit (DPC) and the stock market capitalization (SMC); while the indicator for economics growth is represented by gross domestic products (GDP) growth per capita. The results show greater DPC foster the ASEAN-6 economic growth in the long-run and more relaxed loans as well as non-equity securities regimes of the private sector provide greater opportunity and eventually trigger the development of the private sector which result in a healthier economy. Interestingly, the SMC results confirm the positive relationship between financial liberalization and economic growth of ASEAN-6. Hence, the results offer an evidence of the growth-stimulating effect of financial liberalization among ASEAN-6 countries.

**Keywords:** Financial Liberalization; Economic Growth; ASEAN-6

## 1. Introduction

There is a bulk of academic debates centred around the nexus between the financial liberalization and economic growth (1); a sound financial system promotes financial institutions to be more effective and efficient which results in better economic growth (2, 3), while a poorly behaved financial systems ultimately affect economic growth and reduce economic opportunities (4). It is noteworthy that the link between financial system and economic growth is well researched; nevertheless, there is an impending question of why some countries are financially excluded? Thus, a sound financial system is critical in carving an ideal policy to stabilize economy and progress towards developed nation. Theoretically, financial liberalization policies foster savings; as the results, the investment and economic growth of a nation are also improved (5, 6). The McKinnon-Shaw hypothesis postulates that market liberalization has resulted in higher interest rate which led to better resource allocation, a higher investment and economic growth. Contrarily, the regulated financial system has resulted in financial repression; subsequently, financial system poorly performed and eventually, it hampers the economic growth of a nation.

Although there are immense works on the finance-growth link, results of past studies offer mixed evidence (7-10). Dal Colle (9) states financial development fosters economic growth and Falvey, Foster and Greenaway (2008) claim financial development has insignificant effect on economic growth; while, other past studies argue that financial liberalization causes fragility which caused the risk to the economy (11) (Ang & McKibbin, 2005). Hence, empirical studies of the finance-growth nexus remain to be a popular topic of interest, particularly in developing countries (10, 12-14).

Although the Southeast Asia region has suffered a concatenation of economic crisis, the ASEAN countries have experiencing an astounding structural change and an evident increase in the standard of living from the 1970s to date (Asian Development Bank, 2013). It is noteworthy to mention that ASEAN-6 has taken numerous steps of liberalization since the 1970s. The formation of ASEAN Free Trade Area (AFTA) in 1992, complemented by the 1998 ASEAN Investment Area (AIA) and recent ASEAN Economic Community (AEC) are integral efforts in the pursuit of creating a single market and production base within the Asian region. An essential part of the AEC is targeted at improving her countries' financial policies before promoting ASEAN to the global market (15). With regards to financial liberalization, the ASEAN Comprehensive Investment Agreement (ACIA) was formed under the AEC. The ACIA offers free and open investment by 2015 with the most favorite nation initiative (MFN) and a reduction or removal of investment restrictions on all other countries. In view of the progressing liberalization processes in ASEAN (through the formation of AFTA, AIA, and AEC), this study embarks on a learning journey to investigate financial liberalization and its link to economic growth in ASEAN-6 countries.

For the past 10 years, countries of ASEAN-6 has proven their utmost commitment in liberalizing their economy and enhance growth. Majority of ASEAN-6 countries are ranked top hundred in the Ease of Doing Business Index; Singapore is ranked first, Malaysia and Thailand are at the seventeenth and forty-sixth place respectively while Vietnam and Philippines are at ninety three and ninety seventh place (World Bank, 2015). ASEAN-6 countries forecasted to transform from middle-income to high-income countries in the future (Organization for Economic Co-operation and Development (OECD), 2013). Malaysia is expected to achieve the target in year 2020 while Vietnam will achieve high-income in year 2058 and the other four countries are within the range of year 2020 to year 2058.